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Are We Fighting Inflation Effectively?

A radio discussion over WGN and the Mutual Broadcasting System

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Are We Fighting Inflation Effectively?

MR. McBURNEY: Our speakers today are Daniel D. Carmell, General Counsel, Illinois State Federation of Labor and Chicago Federation of Labor; Thomas W. Rogers, Executive Vice-President, American Finance Conference; and Robert H. Strotz, Assistant Professor of Economics, Northwestern University.

As you have just heard, our question is, "Are we fighting inflation effectively?" This question appears to assume, gentlemen, that we do have inflation and that we are fighting it.

I am wondering how you define "inflation." Rogers, will you answer that?

Goods and Services

MR. ROGERS: Inflation, as most of us know it, has to do fundamentally with the relationship between goods and services, and the amount of these goods and services that we can purchase with the money that we have. Essentially then, most of us think of inflation in terms of price levels. That may be an over-simplified definition but it does have the merit of enabling us to discuss both the cause and effect. I might say, incidentally, that I refer to increases in the general price level. We may have some increases in individual prices while we have decreases in other prices and still not have general inflation.

MR. McBURNEY: Do you go along with that, Carmell?

MR. CARMELL: In my opinion, inflation exists when there is a sharp increase in the amount of money and credits, which then creates an advance in the price level. The reason that I don't go along with the general definition is that there may be goods and services which cannot be purchased because of the lack of money available and that may be depression under that definition.

MR. McBURNEY: Do we have inflation now?

MR. CARMELL: I don't think so. I don't believe that we have inflation in the sense that inflation is generally understood. We have high prices and we have other things, but we do not have inflation in the sense of the general understanding of the word "inflation." We do not have "inflation" in the sense of the fear of the word.

MR. McBURNEY: Are you talking about the kind of thing that happened in Germany in the 20's where prices went out of sight in relation to the currency?

MR. CARMELL: That's the sort of thing I am talking about. That is what I understand to be the general conception of "inflation." The mere fact that prices of certain goods and services may be high is not inflation.

MR. McBURNEY: What do you think, Strotz?

Increase in Price Level

MR. STROTZ: I go along with Mr. Rogers in believing that the customary definition of inflation is a rise in the general level of prices. I think that both Rogers and Carmell can be brought together if we distinguish between inflation meaning a general rise in prices on the one hand and run-away inflation on the other, which is the sort of thing that Carmell has in mind. While inflation means an increase in the general price level, that may be entirely consistent with increases in national output and the level of living of the people in our country.

MR. McBURNEY: I don't think that anybody around the table will question the fact that we have a substantial increase in prices. Whether or not you chose to define it as inflation is neither here nor there.

MR. STROTZ: I might mention that

during the past two years, since the war in Korea, prices have gone up some eleven percent. The rate of increase has perhaps not been so great during the past few months, but it has continued and prices now are at an all-time high.

MR. McBURNEY: What has caused that increase?

MR. STROTZ: Since Korea I think that the blame should be placed on the shoulders of the people who run the Federal Reserve System. We have had substantial increases in bank money in this country—increases of over eleven billion dollars—and that would not have been possible had the Federal Reserve System adopted the proper, traditional, policy measures.

MR. McBURNEY: What would that be?

'Sell Securities'

MR. STROTZ: What they need to do is to sell government securities in order to reduce the amount of reserves that banks must have before they are permitted to increase the amount of money. The Federal Reserve System instead has been buying government securities and that, it seems to me, has been a tragic error.

MR. McBURNEY: How do you feel, about that Rogers?

MR. ROGERS: Of course, I think we have to go back beyond the present situation in order to get perspective on this whole subject. I would first like to say that in the long run there are two major causes of inflation. One is the deficit financing of government and the other is the extraordinary expansion of our money supply through our central banking system. While it may be true that the Federal Reserve System has been acting in the way that Strotz stated, the essential fundamental forces which have been operating in our economy during the last ten years or so may be traced to government deficit financing—deficit financing during the war period—and, of course, on that we have the foundation upon which we base the present policy. Essentially, however, I think that the major forces operating to maintain our present high level of fiscal activity may be traced to the war period.

MR. STROTZ: In order to keep our eyes focused on what sort of policy mistakes we have made, I should like to add to your remarks. During the first two years of the war and until about the middle of this year, the Federal Treasury has actually taken in more cash than it has spent. We have had a cash surplus of eight and three-quarters billion dollars during the past two years and this is not the major explanation of the rise in prices. This is not to say that we do not have a government deficit to look forward to during the next twelve months.

Deficit Financing

MR. CARMELL: This question of deficit financing during a war doesn't impress or concern me very much for this reason. I don't believe that it would have been fair, during the course of a war, to have the entire cost of the war paid by persons participating in that war. It should have an effect upon future generations. You have to take into consideration that government and people are human institutions and they must be treated as such and cannot be simply treated on a theoretical economic basis. Of course, it is better to pay as you go but during the war you had to get services and goods to people who were behind the lines, whose families were there and who had to maintain their morale in order that we should fight.

MR. STROTZ: Whatever justification we may have had for inflation during the past war, I should certainly want to deny that one of them is the prospect of postponing the burden of the war to future generations. The cost of the war is always borne by the people fighting it in terms of the consumers goods and services they are unable to get during that period of time when they are instead producing munitions.

MR. McBURNEY: We have been concerned as a nation with this whole problem of inflation in terms of increase of prices, wages, and so on, and we have been faced with the prospect of wage, price, and credit controls. Such controls have been the essential program for trying to control inflation as I understand it. Do controls of that sort make sense, Mr. Carmell?

Black Market

MR. CARMELL: Only in an alleviating manner. Controls in and of themselves in my opinion do more harm than good for various reasons. First of all, the goods are obtained irrespective of prices. There are price ceilings but the black market comes in. There was a tremendous black market in goods, services, and materials during the war. The result was that money was siphoned into the wrong hands and they were also never taxed. The great bulk of the purchasing power, such as the black market, was never taxed.

The second factor is the question of wages. I don't think that the question of wages had anything to do with the question of higher prices, or particularly inflation, for this reason. When we make our wage contracts we make them as of today and they are in effect for a year, two years, or three years. With the exception of a few people who now have escalator clauses, our wages are in the past. At the end of a contract the cost of living and the cost of goods and materials has already gone up. We try to catch up with the past so that the wage increases do not have an effect upon the inflationary theory in my opinion.

MR. STROTZ: You might say that they are actually caused by increases in the amount of money to be spent —that they are not a primary mover of the price level but that prices increase via wage increases as a result of increases in the amount of money people have available to spend.

MR. CARMELL: That's true. In addition, we are always behind, and that is why we have to wait a year or two until the contract is reopened to try to get what we are entitled to had we been going along, as industry has been, raising prices as costs increased.

MR. ROGERS: My feeling is that if you have and maintain a stable price level the problem which Mr. Carmell points up here will be more or less eliminated. The wage rate which exists today will be adequate and then the question of bargaining between the union and the employer would be that of determining the relative amount of the production which is currently flowing out of their joint efforts.

Controls?

MR. McBURNEY: How are you going to maintain that stable price level? Isn't that the question that we are faced with. Are you going to accomplish that by putting controls on these prices?

MR. ROGERS: My answer is that you cannot accomplish that by putting on controls.

MR. McBURNEY: Why can't you?

MR. ROGERS: Putting these controls on is like putting more weight on the lid of a boiling kettle rather than controlling the fire under the kettle.

MR. McBURNEY: If you can't control the fire under the kettle might it not be a good idea to pile a lot of weight on top?

MR. ROGERS: My contention is you *can* control the fire under the kettle and you ought to. The two major burners, as it were, are the matter of fiscal policy of the government and the action of our central banking system, or the impact which our central banking system will have.

MR. McBURNEY: But so long as we continue to spend billions on our war effort, how effective are you really going to be in controlling the fire under the kettle?

MR. ROGERS: The way to control the fiscal policy burner is to balance the budget—to pay the expenditures of government as you go along. In that way you do not have deficit financing and you do not add through deficit financing to the money supply of the nation.

MR. McBURNEY: What is our national debt, Mr. Rogers?

MR. ROGERS: The last figure indicated that it was about two hundred sixty-three billion dollars. Incidentally, it has gone up about three billion dollars since June.

MR. McBURNEY: That in itself is a lot of pressure under the kettle. That, plus continued war spending, is putting a lot of pressure under the kettle. Are you going to handle that by taxing us as we go and also try to reduce that debt?

'Two Situations'

MR. ROGERS: Let's go back and get another perspective. We have two situations. Of course, we must deal with an accomplished fact. We have a debt. We didn't finance our deficit during the war period and the question is largely a policy question of where do we go from here? In my personal judgment I think that we can reduce these pressures by doing two things. One, of course, is balancing the budget and keeping it balanced. The second is gradually to reduce our public debt. I would say reduce it by a minimum of five billion dollars a year. For the sake of Mr. Carmell here, who would want this war funded over a period of a generation, I would say that it would take us forty-five years to pay for the war because your public debt went up from forty billion dollars to two hundred sixty-three billions. That, of course, would touch the lives of three working generations.

MR. CARMELL: I am not worried about the kettle theory and I will tell you why. The only reason that they want to turn the fire down or up under the kettle is because of the lid being put on. If you keep the lid off you don't have to worry about the lid being blown off. If there is a stable price level it will mean chronic and large unemployment. When there is large unemployment, the government must step in and spend government money, our tax money, for the purpose of priming the pump. It is better to have a shortage in supply of goods and a larger demand for those goods because that means full employment even though a slight increase in prices. And when they buy more the employer's facilities are being expanded, business expands, and unemployment is out of the way. In a free enterprise system of government, I think that's the best way to do it and not worry about putting a lid on the kettle and then worry about whether it is going to be blown off.

MR. McBURNEY: You aren't afraid that this will lead to the sort of thing that happened in Germany in the 20's?

'Faith in Government'

MR. CARMELL: No, because the only reason it occurred in Germany was because of the failure of the government. If we have no faith in the government—and when I speak of the government I am not talking about any political party, Democratic, Republican, Prohibition, Socialistic or otherwise — if government fails to function as a government, inflation will be no problem because you are just not going to have any government—you are going to have an anarchy.

MR. McBURNEY: You are going to let the fire burn and take off the lid—build a little larger pot?

MR. CARMELL: Yes.

MR. STROTZ: I think that Carmell's remarks reflect the fears that a lot of people have about inflation. There are very few of us who would be willing to exchange 1952 for 1933 and there are many of us who are afraid that if we adopt the positive policies that are required to stabilize the general level of prices that unemployment and low production is going to appear in various areas in our economy.

I think that we should also realize that we have been using inflation as a device to cover up various other causes in our economy for unemployment, and I think that what we have done is to turn to a second type or kind of evil.

I know that these remarks may be unpopular but I feel that we ought to attempt to stabilize the general level of prices and if we find that because of maladjustments in our economy that we begin to get decreases in production or unemployment in certain areas, then we should go after this immediately because of those difficulties. I think that we must stand up to this problem and not continually be choosing between those two different evils.

MR. McBURNEY: How would you stand up to this problem?

Prices and Depression

MR. STROTZ: If we have stable prices I do not believe that we run any great danger of serious depression. I do believe that we can get pockets of unemployment with stable prices because some prices in the economy may be too high. For instance, if trade unions insist on forcing up wages in the face of stable prices, that would no doubt mean a drop in employment. I would say that the thing that has to be done through one mechanism or another is stop forcing up wages. We must get prices in proper adjustment consistent with stable prices.

MR. CARMELL: I am very much interested in "pockets of unemployment." I am just wondering how deep these pockets are and in what areas they are going to occur. It is beautiful to use these phrases, but I will say that if labor asks for wage increases and we have stable prices, then we won't necessarily have inflation. First of all, the purchasing power of the general public must be maintained. They can only receive it in the form of wages for the greatest part because that's where the most people buy the stuff. If the material cannot be bought and the people don't have the money to buy it with, there will be no industry. On the other hand, the creation of a shortage of supply by virtue of a demand, by virtue of the fact that persons have money to buy it with, does not create inflation. Consumption is increased.

MR. STROTZ: I think that you misinterpret my position entirely. Because I am opposed to a rise in prices does not mean I am advocating a fall in price. I have been advocating that we follow a policy of stabilizing the general level of prices to maintain adequate purchasing power, so that goods can be purchased without an increase or decrease in the general level of prices.

MR. ROGERS: I think that it is imperative that we maintain a general level of prices and I think that we are all agreed on that. I don't go along with the theory that we have to have a continuing increase in price level. I think that in order to get this matter of stability of prices in focus we have to look at the over-all picture. To put it very simply, if we are going to spend twenty-five per cent of our gross national production or if twenty-five per cent of the value of all goods and services in the nation is going to government, then we are going to have to consider that and pay for it as we go along. It is foolish for us to go ahead and have a deficit, not paying for it, and insist that we can control inflation through price controls, wage controls, credit controls and so on. As a matter of fact, I would like to speak to the question of credit controls before we are through.

MR. McBURNEY: Go ahead now.

Regulation W

MR. ROGERS: Of course, we have heard a lot about the subject of selective credit controls and in the absence of dealing with the fundamental problems I have mentioned, namely the proper fiscal policy, proper control through our central banking system, selective credit controls simply have the effect of distorting or changing the distributive channels within

our whole economic order. They shift pressure from one area to another—they don't end it. We realize what happened the last time Regulation W was enacted. The effect insofar as the automobile market was concerned was to increase commercial credit—credit to businessmen to cover inventories—by an amount greater than the decrease in retail credit. As long as automobiles were produced, they were stacked up in dealers' hands and did not flow into the consumers' hands because they were blocked through this control at that particular level. That is a secondary social cost which is not contemplated and not seen by the average person and by those who might be in favor of credit controls.

MR. STROTZ: I go along with you here and I think that we might group together in one package not only selective credit controls but also price and wage controls, as well as allocation programs. These are all particularistic measures for affecting the way in which we use resources; affecting the direction of the use of credit or affecting the relative levels of different prices. They are devices which might be useful if we maintain that the market fails to perform certain functions properly, but they are not proper devices for controlling the general level of prices or economic activity.

MR. McBURNEY: These proper devices are in the nature of more taxes?

MR. STROTZ: They are broad, general measures which would reduce the total amount of money people have to spend relative to the amount of goods being bought.

Medium of Exchange

MR. CARMELL: It is beautiful to say "pay as you go" and these other phrases. The word "deficit" is a frightening word, but I don't think that there is much to it. The purpose of money is a medium of exchange. What good is money if you are going to keep it in the bank? It is not going to do anybody any good. Money is a medium of exchange and it doesn't make any difference whether it is deficit financing or not. As long as there is a medium of exchange through the use of money and full employment, there is no concern about inflation.

MR. McBURNEY: Yours, Mr. Carmell, sounds like a very popular position, if I may say so. You think that we do not have inflation now. You do not want to increase taxes. You do not want any of these credit controls. You want the pot to boil merrily and you are not concerned?

MR. CARMELL: I am not concerned. If I were concerned, I would be concerned that our form of government just cannot serve its functions in a free enterprise system. I have faith that where there is a raising of the standard of production it means a greater demand for the goods and great increase in the facilities and less unemployment or full employment. What we now have is about this: Wall Street fears a depression; Washington fears inflation; but Main Street thinks that it is doing all right. I am with Main Street.

MR. STROTZ: I think there is a very serious mistake in the reasoning that you have just carried us through. You speak as if an increase in money expenditure is going to mean an increase in the amount of goods and services that we have to consume, the amount of munitions we can produce, or the amount of machinery that can be produced for industry. This is not true for we can have increases in our national income as a result of increase in money expenditures and a rise in prices without anyone having anything more than he had before.

'Value in Constant Dollars'

The important thing is not what happens to the money value of the goods and services produced, but what happens to the real value—the value in constant dollars. We cannot get "pie in the sky" by simply printing more money to spend.

MR. ROGERS: That point is very well made. I submit that we should be concerned about deficits because deficits enable us, through our central banking system, to increase the money supply of the country without increasing, necessarily, the total amount of the production of the goods in the country. That is why we should be concerned with deficits.

Let's go back briefly for just one moment to this matter of allocation of our national resources. I think that in terms of the general social welfare we have to think of the whole of the group, and we cannot have deficits and continue to have them without having inflation; and if we have inflation, ninety-nine per cent of the people suffer.

MR. McBURNEY: Mr. Carmell.

MR. CARMELL: I don't think that we have inflation. What we have is a larger demand for goods than the supply. The high prices resulting from these conditions is not inflation.

Suggested Reading

Compiled by William Huff, and M. Helen Perkins, Reference Department, Deering Library, Northwestern University.

CHANDLER, LESTER V. *Inflation in the United States, 1940-1948*. New York, Harper, 1951.

A study of inflation in the prewar, World War II, and postwar periods. Includes graphs and a bibliography.

Committee for Economic Development. *The Uses and Dangers of Direct Controls in Peacetime*. New York, The Committee, 1949.

The general view of the Committee concerning direct controls with chapters on their use and regulation.

Committee for Economic Development. *Price and Wage Controls*. New York, The Committee, 1951.

A statement on national policy.

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Shows the nature of the economic problem of defense, the size of the military program in the United States, two methods of combating inflation, and the type of taxation needed for defense economy.

HARRIS, SEYMOUR E. *Inflation and the American Economy*. New York, McGraw-Hill, 1945.

A basic text on inflation in all its phases.

HARRIS, SEYMOUR E. *The Economics of Mobilization and Inflation*. New York, Norton, 1951.

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HART, ALBERT G., with Recommendations of the Committee on Economic Stabilization. *Defense Without Inflation*. New York, Twentieth Century Fund, Committee on Economic Stabilization, 1951.

Outlines methods for maintaining an effective civilian economy at a time when defense must be the primary aim.

United States Congress. Joint Committee on the Economic Report. *General Credit Control, Debt Management, and Economic Mobilization*. 82nd Congress, 1st Session. Washington, D. C., Government Printing Office, 1951.

Describes recent monetary and fiscal action and the government's role in making monetary policy.

United States Congress. Joint Committee on the Economic Report. *Questions on General Credit Control and Debt Management*. 82nd Congress, 1st Session. Washington, D. C., Government Printing Office, 1951.

The questions are for government agencies and outside groups. An interesting bibliography is included.

WAAGE, THOMAS O., Comp. *Inflation: Causes and Cures*. (Reference Shelf Vol. 21, No. 1). New York, Wilson, 1949.

Chapters on the causes of inflation, its progress and effects, problems and cures. Includes an extensive bibliography.

American Economic Review 42:273-305, May, '52. "Inflation Control in the United States."

Contains the following articles: "Recent Experience with Monetary-Fiscal Measures to Combat Inflation," by W. THOMAS; "Reflections on a Year of Price Controls," by G. G. JOHNSON; Discussion by A. G. HART and R. B. HEFLEBOWER.

American Economic Review 42:384-91, Je., '52 "Monetary Policy to Combat Inflation."

Recommendations of the members of an economic conference held at Princeton in October, 1951, which was sponsored by the National Planning Association.

Business Week p. 32-3, May 24, '52. "Inflation: the Permanent Dilemma."

Two conferences on inflation reach the conclusion that the long run threat is dangerous enough to warrant using stringent measures to keep prices in check. Suggests methods of accomplishing this.

Commercial and Financial Chronicle 176:109, Jl. 10, '52. "Postwar Inflationary Trends." M. H. PONTIUS.

"Traces the development of the long- and short-term inflationary trends, devoting most attention to events and situations since World War I."

Political Science Quarterly 67:1-17, Mr., '52. "Hedge Against Inflation." C. WARBURTON.

Suggests that determined action by the Federal Reserve authorities to maintain a money supply adequate to keep prices of goods and services stable and making investment in government more attractive than other types would serve as a hedge against inflation.

Readers' Digest 61:15-16, J., '52. "High Taxes Cause Inflation." F. W. MAIN.

Every government tax boost makes for higher prices and wages and greater inflation.

Social Science 27:141-6, Je., '52. "Dept Policy in the 1950's." J. COHEN.

Points out the major economic effects of the public debt, the short run danger of inflation, and the controls needed.

Time 59:75, Je. 30, '52 "Inflation Again."

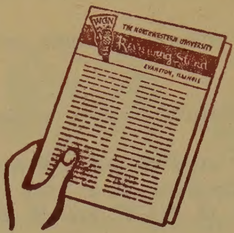
A description of the inflation problems involved when the government floats a bond issue to meet a deficit.

United Nations World 6:25-7, Mar., '52. "Coming End of Inflation." H. HARRIS.

A survey of inflationary tendencies all over the world in the light of United States economics and foreign aid.

U. S. News 32:18-19, Mar. 28, '52 "What's Going on in Business."

Traces the business trend in outline form from 1949 to the possibilities in 1953, with comments in an accompanying article.



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